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Nos. 99-1437, 99-1438

IN THE

SUPREME COURT OF THE UNITED STATES

New York State Dairy Foods, *et al.*,
Petitioners

v.

Northeast Dairy Compact Commission, *et al.*
Respondents

On Petition For Writ of Certiorari
To the United States Court of Appeals for the First Circuit

BRIEF OF AMICI CURIAE IN SUPPORT OF PETITIONS FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Northeast Dairy Compact Commission's practice of imposing a mandatory charge upon processors located outside the Compact region, without regard to whether such charge renders their total product cost higher than the total product cost for in-region processors, violates Congress' limiting conditions: (1) that the Compact Commission abide by procedures established in the federal milk marketing program for inter-market sales of milk; (2) that the Commission not impose trade barriers to the disadvantage of producers and processors located outside the Compact region; and (3) that the Commission not impose compensatory payments as defined by this Court's decision in *Lehigh Valley Cooperative Farmers, Inc. v. United States*, 370 U.S. 76 (1962)?

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INTERESTS OF THE AMICI CURIAE[1]

The Amici are: (1) dairy farmer cooperatives and associations representing dairy farmer members in the states of Iowa, Illinois, Indiana, Ohio, Michigan, Minnesota, Missouri, Nebraska, North Dakota, South Dakota, and Wisconsin;[2] (2) processors and processor trade associations located in Texas, Ohio, Pennsylvania, Indiana, Illinois, and Wisconsin;[3] and (3) members of the United States Congress seeking to protect their respective dairy industry constituents from trade barriers, including the Honorable Herb Kohl, a United States Senator representing the State of Wisconsin; the Honorable Rod Grams, a United States Senator representing the State of Minnesota; the Honorable Russell Feingold, a United States Senator representing the State of Wisconsin; the Honorable John Boehner, a member of the U.S. House of Representatives from the State of Ohio; the Honorable Mark Green, a member of the U.S. House of Representatives from

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[1] No part of this brief was authored, in whole or in part, by counsel for any party to this proceeding, nor has any person or entity (other than amici) made any monetary contribution to the preparation or submission of this brief. Additionally, all parties to this appeal have consented, in writing, to the filing of this brief. Copies of their respective consents are appended hereto.

[2] Associated Milk Producers, Inc., Foremost Farms USA, First District Association, and Minnesota Milk Producers Association.

[3] This group of amici includes the trade associations of Midwest Dairy Foods Association, Inc., Wisconsin Dairy Products Association, and Suiza Fluid Dairy Group, a processor with plants operating in several states across the country. Suiza Fluid Dairy Group joins this brief solely out of its concern that the First Circuit's decision, if not corrected, has the potential for serious adverse effects in federal marketing areas west of the Mississippi River.

the State of Wisconsin; the Honorable Gil Gutknecht, a member of the U.S. House of Representatives from the State of Minnesota; the Honorable Ron Kind, a member of the U.S. House of Representatives from the State of Wisconsin; the Honorable Collin C. Peterson, a member of the U.S. House of Representatives from the State of Minnesota; and the Honorable Paul Ryan, a member of the U.S. House of Representatives from the State of Wisconsin.

They join in urging review of the First Circuit's decision of this matter out of their concern that the First Circuit's decision, by straying from settled milk-regulation principles laid down by this and other Courts as well as in the federal milk regulation program, might subvert long-standing economic rules established to prevent the creation by regulators of artificial cost advantages to particular processors and their producers simply because of regulatory status.

When Congress authorized the Northeast Interstate Dairy Compact ("the Compact") in 1996, Congress placed explicit limiting conditions on the operation of the Compact. 7 U.S.C. § 7256(7) (1999) (effective Apr. 4, 1996). The relevant limitations are as follows: (1) the Compact Commission was prohibited from limiting in any way the marketing in the Compact region of milk produced outside that region; (2) the Compact Commission was directed to "respect and abide by the ongoing procedures between Federal milk marketing orders with respect to the sharing of proceeds from sales within the Compact region" of milk products originating outside the region; and (3) the Compact Commission was prohibited from using "compensatory payments", "as a barrier to the entry of milk into the Compact region or for any other purpose."

That Congress intended for the Federal Milk Marketing Order Program to serve as the prototype for the administration of the Compact is obvious throughout this express statement of limitations. In the first clause, for example, Congress used language that tracks the language in the Agricultural Marketing Agreement Act of 1937 (AMAA). *See* 7 U.S.C. § 608c(5)(G) (1999). In fact, the language contained in 7 U.S.C. § 608c(5)(G) has served as the basis for limiting the conduct of federal milk regulators as to partially regulated processors,[4] and has been relied upon to distinguish between lawful and unlawful compensatory payments for decades. *See Lehigh Valley Cooperative Farmers, Inc., et al. v. United States et al.*, 370 U.S. 76 (1962); *Sani-Dairy v. Espy*, 91 F.3d 15 (3d Cir. 1996) *aff'g Sani-Dairy v. Yeutter*, 939 F. Supp. 410 (W.D. Pa 1993); *Farmland Dairies v. McGuire*, 789 F. Supp. 1243 (S.D.N.Y. 1992); *County Line Cheese Company, et al. v. Lyng, et al.*, 823 F.2d 1127 (7th Cir. 1987).

Given the interrelationship established by Congress between the AMAA, the federal marketing program, and the Compact, it follows that decisions regarding the administration of the Compact may well impact the administration of the federal marketing program.

The First Circuit's opinion in this matter suggests that the existence of a *de minimis* pool distribution would make otherwise unlawful charges lawful, and thus might permit regulators to disregard whether such charges render the total product costs to

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[4] The word processor will be used interchangeably with the regulatory term "handler," and refers to entities that purchase and convert raw milk into finished products such as beverage (fluid) milk, cream, ice cream, and cheese.

out-of-region (*i.e.*, partially regulated) processors higher than the total product costs to in-region (*i.e.*, fully regulated) processors. This proposition conflicts directly with settled milk-regulation law, and could, if extended, be devastating to the stability of the regulated milk-marketing industry.

A central premise of the federal milk regulatory program has long been that stability within and among milk-marketing regions is promoted by equalizing raw-product costs for processors competing in a given market. If some processors are favored in a regulatory scheme by being granted lower product costs, a competitive imbalance is introduced which will threaten stability and orderly marketing, to the economic detriment of the disfavored processors, and the farmers who sell their milk to them, as well as to consumers of milk products. *See Zuber v. Allen*, 396 U.S. 168 (1969). Thus, the federal milk regulation program avoids the destructive short-term competition associated with non-uniform product costs by expressly mandating uniformity of product costs among processors. *See* 7 U.S.C. § 608c(5)(G).

The ruling by the First Circuit in this case ignores the core concept of uniformity of processor costs. By ruling that the Compact may impose on partially regulated processors a mandatory "charge and rebate" mechanism that ignores actual product costs incurred by these processors, the First Circuit decision effectively permits the Compact to impose non-uniform costs. As processors and producers, and as elected representatives of processors and producers, the amici are concerned that as a result of the First Circuit decision, they, or their constituents, may be burdened with the artificial competitive disadvantage, and associated loss of customers and markets, that is created when regulators impose non-uniform product costs, particularly if the

decision transcends the Compact and is applied within the federal milk regulation program.

Moreover, the amici are seriously concerned that because there is now a conflict within the circuits, between the Third Circuit decision in *Sani-Dairy v. Espy*, 91 F.3d 15 (employing the analytical framework set forth by this Court in *Lehigh)* and the First Circuit decision in *New York State Dairy Foods, Inc. v. Northeast Compact Commission*, 198 F.3d 1 (1st Cir. 1999) (ignoring the analytical framework set forth in *Lehigh)*, future courts confronted with similar issues will not have clear guidance. Accordingly, the amici urge this honorable Court to grant the petitions of New York State Dairy Foods, Inc. and Cumberland Farms, Inc., so that this Court will have the opportunity to re-establish with unambiguous clarity the principle that milk regulatory provisions that impose a mandatory charge upon partially regulated processors, without regard to whether that charge renders their total product cost higher than the regulated product cost for fully regulated processors, are unlawful.

SUMMARY OF ARGUMENT

Congress in approving the Northeast Dairy Compact made clear that its consent was conditioned upon the Compact Commission's erecting no economic trade barrier that would limit or discourage the shipment of milk into the Compact region from outside that region.

While approving the central Compact purpose of maintaining higher milk prices in the Compact states than might otherwise exist, Congress made clear that there was to be no Compact provision that would place dairy farmers and processors

located outside the Compact region at a competitive disadvantage in selling their products into the region.

The issue of equalizing product costs between sellers inside a regulated market, and those located outside and shipping into it, arose years ago in the federal program of milk-marketing regulation, and was resolved by this Court. In 1962, this Court in *Lehigh Valley*, 370 U.S. 76, enunciated the fundamental principle that federal regulators could not impose a charge (commonly called in the industry a "compensatory payment") upon out-of-market processors without taking into account those processors' actual existing product costs, because to do so would violate the anti-trade-barrier provision of the AAMA, 7 U.S.C. § 608c(5)(G) by placing those processors at a competitive disadvantage vis-a-vis processors within the regulated market. More recently in 1996, the Third Circuit in *Sani-Dairy*, 91 F.3d 15, affirmed and extended the rule that such charges may not be imposed in the federal regulatory program.

Congress by expressly prohibiting trade barriers and discriminatory compensatory payments, and by expressly adopting established federal regulation principles for dealing with milk shipped into a regulated market, plainly conditioned its Compact consent upon there being no charges of the kind under challenge in this case.

Because the charge levied by the Compact Commission does not in any way take into account the actual product costs already being borne by out-of-region processors, it is an arbitrary and discriminatory charge of the kind beyond Congress' consent. If, in the face of Congress' limiting conditions, the Compact Commission is permitted by means of this kind of charge to

discourage out-of-region processors from shipping their milk into New England, then the long-settled law of regulating inter-market shipments of milk in the federal program will likewise be subjected to risk and uncertainty, given the plain conflict between the First Circuit's Compact decision in this case and the Third Circuit's federal-regulation decision in the 1996 *Sani-Dairy* case.

ARGUMENT

A. Partial Regulation Through the Imposition of A Mandatory Compact Premium Constitutes An Unlawful Compensatory Payment As Defined By This Court in *Lehigh Valley Cooperative v. United States* and by the Third Circuit in *Sani-Dairy v. Espy*, and Therefore Violates the Limitations Set Forth By Congress in its Consent to the Compact

(1) Compensatory Payments Are Commonly Imposed in the Federal Marketing Program to Equalize Product Costs Between Fully Regulated and Partially Regulated Processors.

Congress' consent to the Northeast Interstate Dairy Compact contemplated on its face that the Compact would be administered according to established federal milk marketing principles. Since compensatory payments are nowhere defined in Congress' consent to the Compact, and such consent was written against the backdrop of well-established principles in the federal regulatory program, the prohibition against discriminatory compensatory payments necessarily takes its meaning from these established principles.

Partial regulation of processors is a familiar concept in the federal milk program. Generally speaking, partial regulation involves rules imposed upon processors located outside of, but selling milk into a regulated territory. Typically, the processor will be partially regulated unless and until its sales in the regulated territory exceed a particular percentage of gross sales (which under present rules is 25%) in which case such processors become fully regulated.

Partial regulation is the method by which regulators ensure that parties beyond the reach of full regulation do not receive artificial cost advantages. In the federal milk program, therefore, partially regulated processors are given the opportunity to choose among various devices of partial regulation, which include (1) some form of compensatory payment, wherein a pool payment obligation is assessed to ensure that product costs rise to the level of the minimum product value established by minimum price regulation for fully regulated processors; or (2) voluntary reporting of actual product costs attributable to other factors, such as extraterritorial regulations and/or market forces, wherein the market administrator analyzes the actual amount paid for raw product, to determine if the actual amount exceeds the minimum prices being charged to fully regulated handlers, in which case, no pool payment will be assessed (this is commonly referred to in the industry as "the Wichita option"). *See e.g.*, 7 C.F.R. 1004.76 (1999).

In all cases, the purpose and effect of partial regulation is to protect the fully regulated processors and their producers from the type of unfair competition (and customer loss) associated with unregulated processors being able to undercut the prices of fully regulated processors. By their very nature these tools exist mainly as a method of ensuring orderly marketing and equalizing product

costs among handlers. However, such mandated payments are struck down to the extent they subject partially regulated processors to raw product costs that make sales into the regulated territory more costly than for their fully regulated counterparts. Partial regulation effected through similar methods has existed since the inception of the federal marketing program.

In this regard, Congress' consent to the partial regulation of processors located outside of, but shipping into, the Compact region, accompanied by an express mandate to abide by "ongoing procedures between Federal milk marketing orders" must have contemplated the use of similar devices by the Compact.

(2) This Court and Other Courts Have Prohibited the Secretary of Agriculture From Imposing Compensatory Payments that Cause Partially Regulated Processors to Incur Higher Raw Product Costs Than Fully Regulated Processors.

Congress consented to the Compact with provisos that the Compact Commission (1) would not erect trade barriers that prohibit or in any way limit the shipment of out-of-region milk into the Compact region, and (2) would not use compensatory payments as a barrier to the entry of milk into the Compact region or for any other purpose. 7 U.S.C. § 7256(7). Since compensatory payments are not expressly defined by Congress in the authorizing legislation, understanding what Congress meant by these limiting conditions requires reference to the similar limitations long established in the federal regulatory framework.

The AMAA, which serves as authority for the federal milk regulation program, imposes limits on the Department of Agriculture's power to regulate interstate sales of milk. In particular, the Department of Agriculture has long struggled to strike a balance between the competing mandates of (1) maintaining uniform handler costs, and (2) prohibitions on trade barriers. 7 U.S.C. § 608c(5)(A) and (G). As discussed in the Interests of the Amici, the requirement of uniformity of costs among handlers protects fully regulated processors and their producers from loss of markets to partially regulated processors, who because of differences in regulations, could have artificial cost advantages over fully regulated processors. In the 1950's, in its effort to ensure uniform costs among handlers located in and out of a regulated territory, the Department of Agriculture began to impose "compensatory payments" (pool payments required of handlers located outside of regulated territory, but selling into regulated territory to ensure that handler costs are uniform). However, the compensatory payment scheme became in a sense too effective, in that there were circumstances in which product costs associated with factors external to the compensatory payment, when combined with the fixed charge, made it more costly for the partially regulated processor than for the fully regulated processor.

Relying on the AMAA's express prohibition against trade barriers in section 608c(5)(G), this Court in 1962 made clear that the lawfulness of a compensatory payment charge cannot be ascertained without considering the unregulated (or partially regulated) processor's actual product costs. *Lehigh Valley,* 370 U.S. 76. This Court reasoned that the need for compensatory payments was based on the presumption, which was not always correct, that out-of-region or partially regulated processors could obtain milk more cheaply than those subject to full regulation. *Id.*

at 84-85. This Court recognized that sometimes, however, other regulatory or market factors, serve to ensure that the partially regulatory processor is paying as much or more for raw product. *Id.* Thus, in these circumstances, the additional obligation associated with a fixed mandatory pool payment would disadvantage the partially regulated processor and tend to discourage the marketing of such milk into the area imposing the mandatory payment. *Id.*

After reviewing the legislative history surrounding the drafting of 7 U.S.C. § 608c(5)(G) and determining that "prohibit" as referred to in section 608c(5)(G) "refers not merely to absolute or quota physical restrictions, but also encompasses economic trade barriers ....", *id.* at 97, this Court found that a mandatory pool payment obligation, such as the compensatory payment provision in the case before it, created the potential for economic trade barriers, thus making the provision illegal. *Id.*

In the aftermath of *Lehigh*, the Department of Agriculture continued to utilize compensatory payments, but most often in conjunction with an alternative form of partial regulation known as the Wichita option. *See e.g.*, 7 C.F.R. 1004.76 (1999); *see also* 29 Fed. Reg. 9001, 9109, and 9213 (July 7, 1964). The Wichita option addressed the concern expressed by this Court in *Lehigh* for consideration of actual costs before imposing compensatory payments to equalize costs that do not actually need equalizing. When the Wichita option is available, the risk that the processor will suffer an unfair cost disadvantage is removed.

As late as the 1990s, however, the Wichita option was still not universally available throughout the federal milk regulation system (and is still not available to particular entities shipping into

marketing areas west of the Mississippi). This gave the Third Circuit the opportunity to confirm that the trade barrier ramifications of partial regulation provisions such as compensatory payments must be assessed in light of the partially regulated processor's actual product costs. *Sani-Dairy*, 91 F.3d 15. This particular decision is significant because, as in the Compact, Sani-Dairy, a partially regulated processor, was subject to the same mandatory pool payment obligation on fluid milk sales into the region as fully regulated processors. *Id. aff'g* 939 F. Supp. at 412-413. Also as in the Compact, Sani-Dairy (on behalf of its dairy farmers), being partially regulated, was not granted all of the benefits of pooling. The Third Circuit followed *Lehigh* and found that the product costs incurred outside of, and prior to action taken by regulators, exceeded the total minimum regulated product cost imposed on fully regulated processors, and thus determined that the imposition of the mandatory pool obligation placed Sani-Dairy at an unfair cost disadvantage relative to fully regulated processors, and was therefore unlawful. *Id.*

Thus, a compensatory payment is lawful when it accounts for actual product costs, or is offered in conjunction with an alternative that takes actual product costs into account. On the other hand, a compensatory payment is unlawful and violative of the anti-trade barrier provisions of section 608c(5)(G) when it is set arbitrarily and therefore has the potential to cause a partially regulated processor's total costs (*i.e.*, product costs plus compensatory payment obligations) to exceed the total minimum regulated cost to processors within the regulated market.

(3) The First Circuit Erroneously Assumed That the Compact Commission's Discrimination Against Out-of-Region Processors Was Not a Prohibited Compensatory Payment.

Notwithstanding the long history of assessing the validity and trade-barrier implications of devices, such as compensatory payments, to effectuate partial regulation by measuring actual product costs as opposed to presumed product costs, the First Circuit in this case ruled that the Compact charge at issue was by definition not a prohibited compensatory payment.[5] The Court's decision was based on a perceived, albeit incorrect, distinction between compensatory payments and pool payments, explaining that under a compensatory payment system, the partially regulated plant would receive no disbursements whatsoever from the pool. According to the Court's view, the distinction is vital because it eliminates the primary objection to compensatory payments – that compensatory payments force handlers outside the pool to pay what amounts to a tariff upon entry into the regulated territory.

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[5] The compact charge and the accompanying pool distribution is the mechanism by which the Compact effectuates partial regulation. In particular, partially regulated processors (those located outside of the compact but selling into the compact) and fully regulated processors all pay a *fixed* amount into the Compact pool. However, fully and partially regulated processors receive different pool distributions to pass on to their producers. The partially regulated processor receives less than the fully regulated processors because the Compact pays a pool distribution on the fully regulated processors entire volume (all classes) of milk, while it pays a pool distribution only on the partially regulated processor's volume of Class I milk sales into the Compact. *See* 7 C.F.R. 1301, 1304 and 1307; *see also New York State Dairy Foods Inc. et al v. Northeast Dairy Compact Commission et al.*, 26 F. Supp. 2d 249, 256-57 (D. Mass 1998).

In concluding, as it did, that the very existence of any pool distribution to partially regulated processors (even one that is smaller than that which is paid to fully regulated processors thus resulting in a higher net compact charge on out-of-region milk) eliminated any trade barrier ramifications associated with charging the compact premium to partially regulated processors, the First Circuit demonstrated inadequate regard for the decades of judicial precedent and regulatory precedent during which this Court, various Courts of Appeals, District Courts, and the federal Department of Agriculture, determined that partial regulation may not be effected through mandatory pre-established pool payment obligations. *Lehigh*, 370 U.S. 76; *Sani-Dairy*, 91 F.3d 15; *Farmland Dairies*, 789 F. Supp. 1243; *County Line Cheese*, 823 F.2d 1127.

The First Circuit appears to have been misled by form over substance. Granted, the compact charge and corresponding rebate are different in form from the compensatory payments struck down in earlier cases. It is nonetheless the case, however, that the compact charge and corresponding, albeit reduced, rebate represent the Compact's chosen method of partial regulation. A fully regulated processor would receive a full rebate. Thus, it follows that the compact charge and reduced rebate serve, as do all partial regulation devices, to protect fully regulated processors and their producers from unfair competition and lost markets associated with regulation-induced cost differences.

In addition, the Compact "charge and rebate" has the same substantive effect as the traditional compensatory payment. The Compact "charge and rebate" mechanism, by its mandatory and pre-established nature, leaves open the possibility that an out-of-region processor facing actual product costs, generated by factors external to the Compact, that match or exceed the total minimum

price obligation of in-region processors, will be placed at a cost disadvantage relative to his fully regulated counterparts. This possibility will only be further exacerbated according to the District Court's finding in this case that the lesser rebate applied to out-of-region milk discriminates against and subjects out-of-region milk to a competitive disadvantage. *New York State Dairy Foods, Inc. v. Northeast Dairy Compact Commission, et al.*, 26 F. Supp. 2d 249, 256 (D. Mass. 1998). However, unlike lawful compensatory payments, there is nothing about this method of partial regulation (like the Wichita option) that safeguards against a trade barrier effect.

The compact "charge and rebate" mechanism is mandatory, and imposes on the partially regulated processor a pre-established obligation, which depending on the processor's actual product costs, may or may not competitively disadvantage that processor. Just as the partial regulation mechanisms in *Lehigh* and *Sani-Dairy* were struck down for their potential trade barrier impact and the absence of safeguards, so too should the "charge and rebate" mechanism at issue in this case be struck down. Thus, the First Circuit was simply mistaken when it ruled that the existence of the rebates substantively distinguishes the Compact device from other forms of compensatory payments.[6]

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[6] To avoid the tariff-like impact of the mandatory compact charge and reduced rebate, the Compact would need to track the federal milk regulation provisions pertaining to partial regulation by providing partially regulated processors with a choice between paying the compact premium and receiving on behalf of its producers the reduced rebate on the one hand, and opening its books to establish that actual costs meet or exceed those of fully regulated processors on the other hand. *See, e.g.*, 7 CFR 1004.76 (1999).

By concluding that the mere existence of a pool distribution, no matter how small or large, to a partially regulated handler removes the trade barrier implications associated with compensatory payment provisions, the First Circuit created at least confusion and potentially a dangerous regulatory loophole for the administration by the Compact Commission of previously unlawful compensatory payments.

B. The Confusion Created By the First Circuit's Decision For The Northeast Compact Could Be Employed By Prospective Proponents Of Trade Barriers In The Federal Program In An Effort To Revive The Practice Of Charging Unlawful Compensatory Payments.

Given heavy reliance by Congress on the principles and procedures of the federal milk regulation system in formulating its Consent to the Northeast Compact and the First Circuit's reference to judicial precedent analyzing provisions of the federal milk regulation system, the First Circuit's decision threatens to undermine long-standing principles and precedent defining the trade barriers prohibited by 7 U.S.C. § 608c(5)(G).

The mere existence of a rebate on a mandatory pool payment does not remove the risk that the net charge to partially regulated, or out-of-region, processors could in fact disadvantage them, and thus tend to discourage the marketing of milk into the regulated area. Nonetheless, the First Circuit in this case suggests that the existence of a rebate, no matter how large or small relative to that received by fully regulated processors, somehow should insulate such a mechanism from any trade barrier analysis whatsoever. *New York State Dairy Foods*, 198 F.3d at 10. Thus,

the First Circuit decision, read broadly, suggests there is no circumstance under which judicial review of such a mechanism would be appropriate.

It is possible, therefore, that the First Circuit decision in this case, if not reversed, could be used by those that might benefit from trade barriers to attempt to persuade federal regulators to apply the First Circuit's erroneous logic to federal milk regulation. Federal regulators might, for instance, be urged to formulate some sort of rebate mechanism to insulate from scrutiny otherwise unlawful compensatory payment provisions.

In addition, if a rebate mechanism places partially regulated processors at a competitive disadvantage, the First Circuit decision in this case suggests that these processors would not be entitled to enforce their rights protected under section 608c(5)(G) and this Court's decision in *Lehigh*. A decision that would suggest or permit such a result is dangerous to the processors, producers, and the public, all of whom have come to rely upon a federal milk regulation program that does not erect economic barriers to milk movement between markets.

CONCLUSION

For the foregoing reasons, the amici urge the Court to grant the petitions for *writ of certiorari*.

Respectfully submitted,

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